

I. Executive Summary

A. Introduction

1. blueCONSULTING was retained to perform a financial and management audit of public goods charge collections and energy efficiency expenditures from 1998 through 2002.

blueCONSULTING, INC. was retained by the California Public Utilities Commission (Commission) to perform a financial and management audit (Audit) of utility Public Goods Charge (PGC) fund collections and energy efficiency program expenditures from January 1, 1998 to December 31, 2002 of the state's four major investor-owned utilities (IOUs): Pacific Gas and Electric Company (PG&E), San Diego Gas and Electric Company (SDG&E), Southern California Edison Company (SCE), and Southern California Gas Company (SCG). The objective of the audit is to evaluate utility financial administration and management practices associated with implementation of PGC energy efficiency programs from 1998 through 2002.

2. Significant delays were experienced in the receipt of information, which constrained the audit.

blueCONSULTING began the PGC audit in August 2003, and our field work concluded with the issuance of the first draft of this report on March 31, 2004. Approximately 1,200 data requests were issued. Over 134 formal interviews and a number of follow-up interviews with management and staff at the four utilities were conducted. During the course of the audit, blueCONSULTING experienced significant delays in the receipt of requested data and documents from each of the utilities, and did not receive all of the requested information at SCG and SDG&E. We only received a small portion of the requested labor data at SDG&E, and only received approximately half of all requested audit evidence for the charges classified as "other" at SCG. In addition, due to the system conversion associated with the merger between SCG and SDG&E, Program Year (PY) 1998 cost information for SCG was not available in a usable form for performing detailed testing of individual transactions.

This Executive Summary provides a summary of the results of our audit.

B. Summary of Audit Results

1. Electric rates were properly calculated by all utilities. As a result of sales fluctuations, billed non-CARE electric PGC revenues exceeded revenue requirements by \$55.3 million.

Over the five year audit period, PG&E's, SCE's and SDG&E's electric Public Purpose Program (PPP) rates were developed in accordance with the Commission's requirements, properly computed, and reflected in the utility's tariff. As shown in **Exhibit I-1**, billed non-CARE (California Alternate Rates for Energy) electric revenues exceeded revenue requirements by an estimated \$55.3 million over the five year audit period. During this same period, PG&E's CARE revenues were undercollected and SDG&E's CARE revenues were slightly overcollected. As a result of PG&E's and SCE's balancing account design, PPP overcollections are used to offset transition costs. In contrast, SDG&E records billed PPP revenues and PPP costs in its balancing account. As a result, SDG&E's overcollection was assigned to its PPP balancing accounts.

Exhibit I-1: From 1998-2002, the Utilities' Overcollections of Electric Non-CARE Public Purpose Program Revenues Totaled \$55 Million
(Dollars in Thousands)

	Electric PPPC Revenue Requirement 1998-2002	Billed Electric PPPC Revenues 1998-2002	Over/(Under) Collections 1998-2002
PG&E	\$1,046,724	\$1,121,281	\$74,557
SCE	954,653	924,969	(29,684)
SDG&E	241,500	251,966	10,466
Non-CARE Total	\$2,242,877	\$2,298,216	\$55,339

2. In general, gas rates were properly calculated by all utilities; however, the utilities treat the gas surcharge differently. SDG&E and SCG treat the gas surcharge as an excise tax whereas PG&E treats it as revenue. Treatment of the surcharge as a tax exempts certain customers from the surcharge.

With the exception of PG&E's improper inclusion of Customer Energy Efficiency (CEE) shareholder incentive revenue requirements, all utility gas PPP rates were calculated correctly during the period 1998 through 2002. PG&E erroneously included an amount for CEE shareholder incentives in its PPP surcharge rates rather than in its core gas transportation rates; however, this has no net effect on PG&E's ratepayers.

Both SDG&E and SCG treat the PPP gas surcharge and payments to the Board of Equalization (BOE) as an excise tax, whereas PG&E treats the gas surcharge as revenue. The differing treatment affects the amount of gas surcharge revenues billed to customers. In 2001 and 2002, about 60 percent of SDG&E's and SCG's gas sales were exempt from the surcharge, compared to 46 percent for PG&E. The accounting treatment of the gas PPP surcharge, as well as other issues, is the subject of a current Commission proceeding. At time of the completion of our field work, the proper treatment of the gas surcharge had not been resolved.

3. Utility oversight and funds management controls are generally adequate; however, improvements are possible at all utilities, particularly in the areas of procurement and vendor oversight.

In this area we reviewed the utilities' accounting oversight and funds management. Specific areas reviewed include: corporate control environment; program design and funding; program oversight and management; accounting and cost tracking controls; and compliance. The adequacy of controls varied by utility (greater weaknesses were observed at SCG than at the other utilities); however, opportunities for improvement in program controls were identified at all utilities. Areas for improvement include separation of duties, checks and balances, system overrides and approval levels. Improvements in accounting and cost tracking activities are also possible at the Sempra utilities.

Although program design and funding is a collaborative process, driven partly by Commission goals, most of the utilities adequately fulfill their responsibilities in this area. The primary exception is SCG which relies too heavily on the Commission for program and budget design.

Areas for improvement in program management and administration were identified at all utilities. Perhaps the greatest weakness at most utilities was in the procurement and contractor selection process and vendor oversight, as summarized below:

- SCG and SDG&E have no formalized policies and procedures that define and control the decision-making process regarding the use of in house staff versus contractors, or regarding competitive bidding. The process for providing on-site inspections at the Sempra utilities is weak and needs improvement. Documentation for many of the inspections does not exist and is not even required by SCG. Voucher processors at SDG&E and SCG are allowed to override system selected inspections leading to customers who were paid even though inspections did not occur.
- SCE's procurement practices are inadequate and the utility does not utilize appropriate criteria when making initial outsourcing decisions. Significant vendors have sole-source contracts at SCE and competitive bidding is infrequent. Invoices are extensively reviewed and audited, however direct procedures are not in place to ensure that the work for which invoices have been submitted has actually been performed. No direct work is performed to ensure that work has actually been done as described in the documentation.

Exhibit I-2 summarizes the results of blueCONSULTING's review in the area of accounting oversight and funds management:

Exhibit I-2: Overview of Utility Controls

Area	Adequate (Yes/No?)			
	PGE	SCE	SDGE	SCG
Corporate Control Environment				
1. Management organization provides adequate direction and oversight. There is effective communication to address problems and avoid mistakes.	Yes	Yes	Yes	No
2. Executive management is committed to internal control and regulatory compliance. Related compliance programs are adequate.	Yes	Yes	Yes	No
3. Organization design and staff contributes to appropriate control environment. <ul style="list-style-type: none"> ▪ Separation of duties is adequate. ▪ Staff is knowledgeable and adequately trained. ▪ The utility ensures staff continuity. 	Yes	Partial	Yes	Partial
4. The internal audit function of the PGC program is adequate. <ul style="list-style-type: none"> ▪ Audits are conducted by qualified personnel. ▪ Audit plans incorporate periodic reviews of major systems, tests of regulatory compliance, and program specific audits. They provide for appropriate follow-up. ▪ Independent audits are performed in accordance with regulatory requirements. ▪ Management initiates corrective action on findings 	Yes	No	Yes	No
Program Design and Funding				
5. The utility's PGC personnel participate in statewide workshops and contribute to program design and reporting requirements.	Yes	Yes	Yes	Not studied
6. The utility has developed an appropriate process for timely identification of changes in regulatory requirements and incorporating these requirements into its energy efficiency programs. Commission requirements are adequately communicated to project managers, who are held accountable for compliance with Commission requirements.	Yes	Yes	Yes	Yes
7. Procedures are in place to ensure program selection; budgeting and funding are performed within Commission guidelines.	Yes	Yes	Yes	Partial
Program Oversight and Management				
8. Management performs effective oversight of PGC programs. Management reviews actual performance versus budgets and program goals.	Yes	Yes	Yes	Partial
9. The utility has established appropriate procedures for determining committed funds, tracking expenditures against commitments and releasing commitments.	Yes	Yes	Yes	Partial
10. PGC procurement policies are appropriate and consistent with corporate procurement policies. <ul style="list-style-type: none"> ▪ There is a formal decision-making process for outsourcing vs. in-house work. ▪ There is a competitive contractor selection process. ▪ Contractor/vendor relationships are evaluated periodically. ▪ There is compliance with purchase order approval limits. 	Yes	No	No	No
11. Contractor oversight and monitoring is adequate. <ul style="list-style-type: none"> ▪ The Energy Efficiency group has established procedures to monitor and control contractor activities. ▪ Work performed by contractors is verified. ▪ Contractor/vendor invoices are reviewed to ensure accuracy. 	Yes	No	Partial	No
12. On-site inspections are performed as appropriate.	Yes	Partial	No	No

Area	Adequate (Yes/No?)			
	PGE	SCE	SDGE	SCG
Accounting and Cost Tracking (Control Activities)				
13. PGC program revenue and disbursements systems are integrated with the financial accounting systems and are adequately designed and documented.	Yes	Yes	No	No
14. Program managers receive monthly budget vs. actual cost reports. Reviews are conducted to ensure program charges are appropriate, and variances are reviewed and resolved.	Partial	Yes	Yes	Partial
15. The utility has established appropriate checks and quality control procedures regarding payment of incentives.	Yes	No	Yes	Partial
16. Authorization levels for expenditure approval are appropriate.	Yes	No	No	Partial
17. There is adequate rebate application review and approval.	Yes	Partial	Yes	No
Compliance (Program Rules)				
18. Program reporting is based upon information contained in the accounting records and is in compliance with Commission requirements.	No	Yes	Yes	Partial
19. Participant eligibility for a program is determined.	Yes	Yes	Yes	Yes

4. With the possible exception of SCG's interest calculation, no material adjustments to recorded costs were identified by the audit; however, blueCONSULTING was unable to conclude a portion of the Sempra utilities' costs were properly accounted for due to limited supporting documentation. SCG's method for calculating interest charges and credits to the Conservation Expense Account (CEA) differs from the method used by SGD&E, and from the method used by SCG for other balancing accounts. Through August 2003, SCG recorded \$608,509 of interest in the CEA. Under a more traditional method, SCG would have recorded (\$7.4) million, a difference of (\$8.0) million.

During the 1998-2002 audit period, the utilities spent \$1.1 billion on energy efficiency programs, approximately \$261 million less than the authorized revenue requirement, as shown below.

Exhibit I-3: From 1998 through 2002, the Utilities Spent \$261 Million less on Energy Efficiency Programs than the Authorized Revenue Requirement [Note 1]

(Dollars in Thousands)

Utility	Revenue Requirement	Expenditures	Difference
PG&E	\$594,340	\$465,548	\$128,792
SCE	409,287	325,934	83,353
SDG&E	222,901	172,225	50,676
SCG	135,857	137,966	(2,109)
Total	\$1,362,385	\$1,101,673	\$260,712

Note 1: Does not include commitments.

With minor exceptions, PG&E's direct costs relating to energy efficiency program delivery including labor, non-labor and incentives are properly supported and classified as energy efficiency costs in accordance with applicable accounting principles and regulatory

requirements. The audit indicates almost all Provider Cost Center (PCC)-driven costs in the energy efficiency programs are appropriate; however, there are some charges from PCCs with no direct involvement in energy efficiency activities. Supervisory and interdepartmental charges to energy efficiency programs include \$255,000 for payroll taxes and benefits, which are also included in base rates.

In general, SCE's direct energy efficiency costs are properly supported and classified. Minor exceptions and control deviations were noted; however, no material adjustments were identified. SCE charged only three categories of allocated overhead costs to the energy efficiency programs during the audit period: charges from other departments; lease costs associated with one facility; and general administrative costs which were segregated and allocated back to the programs beginning in 2002. General administrative costs were incurred and charged against PGC funds throughout the audit period; however, in 2002 the Commission required that these costs be allocated to the individual programs. SCE did not retain support for the majority of the inter-departmental charges; therefore, examination and testing of these charges was limited. Although our analysis was limited, we identified categories of overhead costs which had been included in base rates, but were incorrectly charged against PGC funds.

blueCONSULTING's audit identified some problems with SDG&E's documentation and classification of costs. In general, rebates and incentives, labor-related overhead charges and costs classified as "other" were adequately supported and properly classified; however, audit tests revealed some departures from program requirements. Documentation of employee labor charges is inadequate. Further, blueCONSULTING is unable to conclude direct labor costs are reasonable and properly classified because of the large number of exceptions in the test sample. SDG&E also provided an inadequate explanation and was unable to support the amount of Material Procurement and Logistics (MP&L) overheads included in the energy efficiency program costs.

In general, based on the limited documentation provided to blueCONSULTING during the audit, there are problems with SCG's classification of costs and its support of such costs. It is difficult to draw meaningful conclusions because SCG did not retain sufficient records from its early systems after conversion to SAP. SCG's expenditure accrual process is problematic and the informality surrounding the tracking of expenses and adjustments diminishes the accuracy of expense accumulation. Labor costs are allocated rather than directly charged to the programs, and there are limited controls over cost adjustments.

5. Administrative cost levels and the reporting of administrative costs varied considerably by utility as a result of differences in accounting and reporting systems, differences in what is included in the utilities' base rates, and limited written guidance regarding allowed energy efficiency expenditures or their classification.

Historically, the California utilities have received limited written guidance regarding the classification of administrative costs or allowed categories of costs, and past definitions have been too broad to allow meaningful comparisons of administrative cost levels. The Reporting Requirements Manual 2 (RRM2), first issued in 1999, outlined the required content for the Annual Report for post-1997 programs, but did not specifically define the labor, non-labor, or contract costs within the administrative cost category. As a result, the types of costs each utility reports in each Annual Report category vary considerably. The 2002 Quarterly Reporting Workbooks request cost information at a greater level of detail than the annual reports.

However, the level of requested detail implies an accuracy and specificity of the reported information that may not be representative of the underlying data. As a result of differences in accounting and reporting systems, differences in what is included in the utilities' base rates, and the lack of specificity regarding allowed energy efficiency expenditures, there are significant differences in the types of costs each utility charges against PGC funds, and administrative costs levels vary by program. As a result, caution must be exercised in making comparisons or establishing caps.

C. Recommendations

Exhibit I-3 provides a list of audit recommendations. Recommendations for the Company and policy issues for consideration by the Commission are included in each utility section of each chapter of this report. As a result, the recommendation numbering listed below will not directly match the numbering in the detailed audit report chapters.

Exhibit I-4: Audit Recommendations [Note 1]

Utility	Recommendations for the Utilities
Revenue	
PG&E	1. PG&E should make a one time adjustment to the PPP revenue requirements in the Transition Revenue Account (TRA) to adjust for the \$210,759 CARE administrative costs requirements which were inadvertently excluded in 2001.
SCE	None.
SDG&E	None.
SCG	2. If required by the Commission, SCG should revise the balancing accounts to reflect changes in the interest calculation as discussed in Chapter IV.
Commission	3. The Commission should determine whether the gas PPP charge should be treated as revenues or as a tax, and require consistent accounting treatment by the utilities. Treatment of the surcharge as a tax may have unintended consequences with respect to the number of customers exempt from the surcharge.
Accounting Oversight and Funds Management	
PG&E	4. PG&E should tighten its administrative controls over the Savings by Design and Standard Performance Contract programs. 5. PG&E should review its customer files related to commitments to identify projects which have been inactive for an inordinate length of time and determine whether these should be excluded from reported commitments.
SCE	6. The charter of the Internal Controls function should be reviewed, and the work of Internal Audit should be expanded. 7. The assignment of processing duties should be reviewed and modified to preclude the possibility of the same individual controlling all phases leading to payment of incentives. The practice of having checks returned to program staff by accounts payable should be discontinued. (According to SCE, a procedure has been implemented to ensure incentive checks are mailed directly from SCE Accounts Payable to the recipient.) 8. The criteria for outsourcing vs. in-house processing decisions should be reviewed and updated to reflect the status of mature programs.

Exhibit I-4: Audit Recommendations [Note 1]

Utility	Recommendations for the Utilities
	<p>9. The contractor and vendor selection process should include more frequent competitive bidding. The practice of extending the term and/or increasing the contract costs through frequent change orders should also be reconsidered. The approval authority limits and/or processes for sole-source contracting and for purchase order changes should be lowered to make current practices more visible within the organization.</p> <p>10. Contractor and vendor monitoring and verification processes should be strengthened by the development of direct processes to ensure that the work was actually performed.</p> <p>11. Consolidation of processing functions, centers and systems should be comprehensively reviewed in 2004.</p> <p>12. As part of the consolidation review, the use of multiple tracking systems/databases should be reconsidered.</p> <p>13. The discretionary overrides of programs selected for inspection and the lack of an audit trail or review of the overrides in the Residential Rebate and Express Efficiency tracking systems should be reviewed by CSBU internal controls.</p>
SDG&E	<p>14. SDG&E should modify how it approaches fund shifting opportunities to be more consistent with Commission guidelines. Specifically, fund shifting should no longer be considered a method of accommodating budget overages, but rather should be viewed as a method of optimally redeploying funds that cannot be used for their original purpose.</p> <p>15. SDG&E should incorporate the attainment of energy efficiency program goals into the performance reviews of Energy Efficiency Managers and Program Managers. It is recommended that SDG&E add the Competency "Energy Efficiency Program Goals Attained" on all performance reviews.</p> <p>16. PGC Program Management should modify the procurement policy related to contract requirements, and procurement controls should be strengthened.</p> <p>17. SDG&E should develop a process to ensure that individuals approving requisitions have the appropriate level of authority. One potentially cost-effective approach would be to incorporate approval limit confirmation into SAP. SDG&E should limit the authority to delegate approvals, particularly the ability to delegate approval authority to lower ranking individuals. Approval delegations should be temporary in nature based on specific events, i.e., vacations or short-term leave of absence, temporary assignment to special projects.</p> <p>18. System controls in SDG&E's Energy Efficiency Tracking System (EETS) should be re-evaluated with particular attention paid to the Processors' ability to override system generated alerts or information. Where the ability to override fields is needed, SDG&E should require that an explanation be entered into a Comments field. Furthermore, the override should be tracked in a system log noting the user's identity, and the date and time of the override. The information in the override log should be kept permanently, as opposed to the current practice of only capturing information pertaining to the most recent change.</p>
SCG	<p>19. SCG should strengthen its "tone at the top" with regard to compliance with Commission directives and guidelines in the programs area within increased formal communications and increased formal, internal financial reporting.</p> <p>20. Increase the frequency of internal or external audits of energy efficiency programs to ensure that the programs are properly managed and that appropriate controls are in place.</p> <p>21. Require routine, formal performance reporting (budget performance and performance against goals.) Reports should be disseminated to and reviewed by management.</p>

Exhibit I-4: Audit Recommendations [Note 1]

Utility	Recommendations for the Utilities
	<p>22. SCG should adopt stronger controls surrounding the reclassification of costs and expenses. Currently, a program manager can transfer expenses from one program to another based upon his/her judgment alone of what is appropriate. Such reclassifications of costs or expenses should be justified by detailed estimates or calculations. A change in policy would preclude expenses from being adjusted to meet authorized funding levels, a practice which is tantamount to shifting funds outside the guidelines set out by the Commission.</p> <p>23. Identify primary reasons for not meeting energy savings for all projects and ensure that future goals are met. SCG should develop the procedures and formal periodic reporting necessary to support informed monthly reviews and intelligent decision-making in response to reported progress toward program goals.</p> <p>24. Increase the accuracy of reporting by ensuring that energy savings associated with commitments dropped in future years are routinely “trued-up” against the energy savings amounts claimed in the year of the commitment. SCG should develop a system to track commitments, scheduled payments, expiration dates, and released funds in real-time.</p> <p>25. Strengthen the process used to select contractors, including utilizing competitive bidding.</p> <p>26. Improve vendor management processes.</p> <p>27. Improve the on-site inspection process.</p> <p>28. SCG should redesign and upgrade procedures and systems to include standard procedures, systems with controls and standard reports, and the use of new system capabilities to manage programs effectively. PGC program disbursements are based on offline systems and non-ledger memorandum accounts. SAP is used, but only for cost accumulation and limited variance reporting of program expenditures against authorized budgets.</p> <p>29. SCG should undertake significant systems improvement in the entire program management area.</p> <p>30. Establish appropriate checks and quality control procedures regarding payment of incentives and rebates.</p>
Commission	<p>31. Determine whether PG&E's use of PY 2000 contracts for PY 1999 Savings by Design incentives constitutes fund shifting. If appropriate, consider disallowing \$1.4 million in Savings by Design program customer incentive payments or grant PG&E retroactive approval to shift unexpended PY 1999 funds to PY 2000.</p> <p>32. The Commission should develop new policies to better manage programs with commitments and reservations. Currently, certain of the utilities offer incentives only until Actual plus Committed Expenditures equal 100 percent of the available budget. Since some amount of cancellations is expected, this ensures that these programs under-spend available incentives. Utilities can take it upon themselves to establish a policy of accepting commitments to some level over 100 percent; however, this causes the utility to bear the risk of implications if the program goes over-budget.</p> <p>33. The Commission should clarify its intent regarding cost category level budgets, specifically regarding i) whether these are guidelines or actual budgets which should be adhered to and ii) circumstances under which deviations from cost category level budgets are acceptable.</p>
Costs	
PG&E	<p>34. PG&E should reclassify the misclassified incentive payments (\$51,000) and adjust the balancing account as necessary to eliminate costs from PCCs that do not support energy efficiency (estimated at less than \$500,000) and \$255,000 of gas labor-driven pension and payroll taxes that are in base rates.</p> <p>35. PG&E should strengthen its controls to ensure that costs are recorded with the correct cost element in SAP.</p> <p>36. PG&E should correct the algorithm in its timesheets so that when an individual works more than 40 hours per week, there is a consistent basis to reduce actual hours charged to each order to reflect a 40 hour week.</p>

Exhibit I-4: Audit Recommendations [Note 1]

Utility	Recommendations for the Utilities
	<p>37. PG&E should review the charges to its energy efficiency programs from non-CEM or Account Services PCCs to identify any erroneous charges, even though the amount is small (less than \$500,000).</p> <p>38. PG&E should make the appropriate adjustments to the balancing account to correct the overstatement of electric burdens.</p>
SCE	<p>39. SCE should adjust the balancing account in the amount of \$194,509 to account for incorrect charges identified by the audit. Going forward, an additional accuracy check of the accounting coding should be performed by a financial member of the energy efficiency team, prior to submission of the invoices for processing.</p> <p>40. If possible, SCE should eliminate the practice of advances for advertising. If not, expenditures against advances should be made within the same program year.</p> <p>41. Investigate procurement card violations and eliminate cards as necessary. Enforce the requirement that management review purchases for compliance with corporate and CSBU requirements prior to approving purchases. Future abuses should be dealt with promptly. According to SCE, as a result of our audit, procurement cards have been cancelled.</p> <p>42. The guidelines and methodology used to allocate expenses between PGC and operations and maintenance (O&M) for SCE's energy centers should be modified to clearly state how the allocations should be handled for all shared expenses. Additional review of energy center charges should be performed to ensure costs have been accounted for correctly.</p> <p>43. SCE should retain support for all charges associated with energy efficiency programs, regardless of source, while subject to Commission audits. The base rates determined at the beginning of each year should be documented and supported. All charges to PGC programs should be supported including the calculation of the amount charged. All supporting accounting documentation should be retained.</p> <p>44. Going forward, human resource/ training costs, internet access, desktop and laptop services, telephone services, and radio/communication IMM costs should not be charged to the energy efficiency programs, as these categories of costs were included in the design of base rates.</p> <p>45. SCE should confirm the validity of the adjustments made to its energy efficiency cost balancing account in 2000 and 2001.</p>
SDG&E	<p>46. The Corporate Controller should review current practices relating to SDG&E's Workforce Information Tracking System (WITS) data entry and records retention for energy efficiency labor charges to ensure that future charges are adequately supported.</p> <p>47. Energy efficiency program management personnel should eliminate the need for payment of overtime premiums to customer services and other personnel asked to staff display booths at community outreach events. Arrangements for compensatory time off from the person's regular assignment might eliminate the overtime situation.</p> <p>48. SDG&E should enforce its established policies and procedures relating to procurement of energy efficiency goods and services including approval of contracts with former employees by the Sempra Energy Project Review Committee, use of competitive bidding practices, proper documentation for vendor travel and entertainment expenses, approval authorities, and data entry.</p> <p>49. SDG&E should investigate the reasons for the apparent MP&L discrepancies noted in the audit and make appropriate adjustments, if necessary.</p>
SCG	<p>50. SCG should make adjustments to its balancing account to reflect the portion of \$166,000 of website design costs that are not energy efficiency related. It should also reclassify the costs which were erroneously charged to PY 2000.</p>

Exhibit I-4: Audit Recommendations [Note 1]

Utility	Recommendations for the Utilities
	<p>51. SCG's allocation of labor costs to energy efficiency programs should be recorded based on the actual effort expended on the various cost elements. This would provide accurate information as to the true costs of individual programs and assure the costs are properly reported to the Commission.</p> <p>52. SCG should develop policies and procedures that will improve the Company's ability to properly classify costs to the program year to which they apply.</p> <p>53. SCG should develop policies and procedures to charge only the portion of costs that are related to energy efficiency programs to those programs.</p> <p>54. SCG should overhaul its employee expense reporting policies to bring reporting standards at least to that required by the Internal Revenue Code. That would require that expenditures be backed by a statement of business purpose and a list of persons in attendance with company affiliations and/or titles. Also, a record of the expenditure detail should be kept such that it can be known what was purchased with a credit card charge.</p> <p>55. SCG should raise the threshold of accountability for reclassifying costs from one internal order (which roughly corresponds to a program) to another. Currently, reclassifications are numerous, large, and not supported by analysis or rationale. The volume of reclassifications threatens the accuracy of the cost data accumulated to specific programs and to specific cost codes. Reclassifications should be made only on the basis of a reasoned statement of the need to reclassify and a written estimate of the amounts, supported by a written calculation. Shifting expenses to match expenses to program budgets should be prohibited, as this is tantamount to fund shifting outside the fund shifting guidelines.</p>
Commission	<p>56. The Commission should review SCG's interest calculation, clarify its position with respect to interest calculation methodologies, and require adjustments as necessary to the CEA account and any other balancing account where a similar calculation methodology was employed.</p> <p>57. The Commission should adopt a standard that any non-GAAP or unusual financial measurement techniques be explicitly stated by the IOU in each report to the Commission where such non-GAAP accounting is incorporated.</p>
Cost Classification and Reporting	
PG&E	See Commission recommendations below.
SCE	See Commission recommendations below.
SDG&E	See Commission recommendations below.
SCG	<p>See Commission recommendations below.</p> <p>58. SCG should develop an accounting structure for energy efficiency programs which facilitates the reporting of costs in accordance with the Commission requirements. Other utilities, such as PG&E, have specifically created accounting orders in order to obtain the data necessary to meet the Commission's reporting requirements.</p>
Commission	<p>59. Prior to determining administrative cost limits or performing comparative analyses, the Commission should develop consistent standards regarding what are allowable energy efficiency costs, and how these costs should be classified. It is not possible to specify minimum or maximum administrative cost limits without a solid definition of what these costs include.</p> <p>60. The utilities and the Energy Division should work together to develop reporting requirements that meet the needs of the Commission and provide accurate, consistent information, but are not unduly burdensome for the utilities, and take into account the manner in which the utilities' accounting systems aggregate costs.</p>

Exhibit I-4: Audit Recommendations [Note 1]

Utility	Recommendations for the Utilities
	61. The Commission should consider a requirement that each reporting utility file with its quarterly and annual reports an affirmation signed by an officer with the IOU that states a) that the utility has a reliable system of recording and summarizing costs; b) that the system is subjected to quality control testing, such as internal audits; c) that employees receive sufficient training in the use of the system and in Commission reporting requirements; and d) that errors found are corrected immediately and procedures reviewed to avoid similar errors occurring in the future. Absent such a positive affirmation (which all publicly-held utilities now provide to the SEC for their financial statements as a whole), the belief that filing the annual report discharges all utility reporting responsibilities to the Commission will continue.

D. Conclusions

Exhibit I-4 provides a list of audit conclusions by utility. Numbering reflects the conclusion numbers included in the conclusion sections of the detailed audit report. As a result, the numbers shown in Exhibit I-4 may not be consecutive.

Exhibit I-5: Conclusions by Utility

1. Revenue

Review Area	PG&E	SCE	SDG&E	SCG
Revenue Requirements and Rate Design - Electric	<p>1. PG&E's initial electric PPP rates were developed in accordance with the Commission's requirements, properly computed, and reflected in the utility's tariff.</p> <p>2. PG&E's electric PPP rates were revised four times between January 1, 1998 and December 31, 2002. blueCONSULTING's review of PG&E's rate calculations and the supporting material associated with those filings determined that the rates were properly computed.</p> <p>3. Although Resolution E-3792, issued December 17, 2002, increased PG&E's PPP revenue requirements by \$21.1 million, Resolution E-3792-E required PG&E to file the changes to the PPP rates to reflect the adopted revenue requirement in Phase 1 of PG&E's 2003 General Rate Case.</p> <p>4. The PPP revenue requirements recorded in the TRA underestimate the PPP revenue requirements by \$210,759 million during the period 1998 through 2002 due to the inclusion of an incorrect amount for CARE administrative costs in 2001.</p>	<p>16. SCE's initial electric PPP rates were developed in accordance with the Commission's requirements, properly computed, and reflected in the utility's tariff.</p> <p>17. The January 1, 1998 PPP rates were revised on August 2, 1999 and again on March 16, 2001. The 1999 and 2001 PPP filings and rate calculations were made in accordance with the Commission's requirements.</p> <p>18. There were two revisions to SCE's revenue requirements that occurred during the 1998–2002 period which did not result in revised PPPC rates.</p>	<p>22. With the exception of the application of the System Average Percent Change (SAPC) methodology, the initial PPP electric rates established effective January 1, 1998 were developed in accordance with Commission requirements, were properly computed and are properly described in the Company's tariffs.</p> <p>23. At the time of the lifting of the rate freeze in 1999, SDG&E properly implemented a PPP rate change in accordance with the Commission's requirements. The PPP rate was not changed until 2004 to account for an increase in the Research Demonstration & Development (RD&D) revenue requirement specified in P.U. Code Sec. 399.8 adopted December 17, 2002.</p>	NA
Regulatory Accounts - Electric	<p>5. The PPPEEEBA balancing account properly includes the \$106 million annual energy efficiency revenue requirement for Program Years 1998 through 2002.</p>	<p>21. SCE properly recorded the approved PPP revenue requirements in its balancing accounts.</p>	<p>24. PPP revenues are properly recorded in the balancing accounts using the PPP rate applied to actual billed volumetric sales, and the percentage allocation to programs established in 1998.</p> <p>25. blueCONSULTING's review of revenue entries to the SDG&E PPP balancing accounts during the 1998–2002 audit period disclosed no significant matters requiring further investigation.</p>	NA
PPPC Revenues - Electric	<p>6. Prior to September 1999, PG&E was not able to report unbundled revenues by customer class due to limitations in its customer information system (CIS).</p> <p>7. blueCONSULTING's analysis indicates that during the period 1998 through 2002, PG&E billed approximately \$39.2 million (3 percent) more than the authorized \$1.1 billion electric PPP revenue requirements for this period. CARE costs were undercollected by an estimated \$35.3 million, and non-CARE costs were overcollected by an estimated \$74.6 million.</p>	<p>19. Prior to 2000, SCE's revenue reporting system (CRRIS) was not able to report unbundled revenues by customer class. Total unbundled revenues were tracked, but the unbundled components by customer class were not.</p> <p>20. During the period 1998 through 2002, SCE's billed non-CARE PPPC revenues totaled \$1.1 billion dollars, an estimated \$29.7 million less than the non-CARE PPPC revenue requirement. Undercollections result from differences between actual kWh sales and forecast sales used in the PPPC rate design.</p>	<p>26. SDG&E billed customers approximately \$12.3 million more than the \$283.8 million electric PPP revenue requirements in the 1998–2002 period.</p>	NA

Exhibit I-4: Conclusions by Utility

1. Revenue

Review Area	PG&E	SCE	SDG&E	SCG	
Revenue Requirements and Rate Design - Gas	<p>8. With the exception of the improper inclusion of CEE shareholder incentive revenue requirements, PG&E's gas PPP rates were calculated correctly.</p> <p>9. During the audit period, PG&E erroneously included an amount for CEE shareholder incentives in its PPP surcharge rates, rather than in its gas transportation rates; however this has no net effect on PG&E's ratepayers.</p>	NA	<p>27. During the period 1998-2002, SDG&E's gas surcharge rates were calculated in accordance with the Commission requirements.</p> <p>28. When the PPP gas surcharge was removed from the transportation rate and a new gas surcharge rate established effective July 1, 2001, SDG&E properly computed the new rate in accordance with Commission requirements, and added it to its approved tariffs.</p>	<p>33. SCG's gas surcharge rate changes were calculated in accordance with Commission requirements.</p>	
PPPC Revenues - Gas	<p>10. In contrast to SDG&E and SCG, PG&E treats the gas PPP surcharge as revenue, rather than as an excise tax.</p> <p>11. In accordance with Resolution G-3033, PG&E began to track the PPP revenues starting January 1, 2001, and showed the PPP rate as a separate line item on customers' bills by July 1, 2001.</p> <p>12. blueCONSULTING's analysis indicates that during the period 1998 through 2002, PG&E billed an estimated \$3.8 million (3 percent) more than the authorized \$253.5 million gas PPP revenue requirements for this period.</p> <p>13. PG&E's payments to the State Board of Equalization (BOE) were calculated in accordance with Commission-approved PPP rates. However, as a result of changes in surcharge rates billed to customers, \$2.6 million more revenue was billed to PG&E customers than what was sent to the BOE.</p> <p>14. The remitted revenues PG&E sent to the BOE in years 2001 and 2002 exceed PG&E's claimed amounts for 2001 and 2002 gas CARE, LIEE, and Energy Efficiency expenses by \$13 million.</p>	NA	<p>29. Although there is no indication that SDG&E did not follow the Commission's prescribed accounting and reporting requirements, during the period from 1998 through 2000, it is not possible to determine the actual amount of PPP revenues derived from the Company's gas operations.</p> <p>30. SDG&E treats the PPP gas surcharge and payments to the Board of Equalization (BOE) as an excise tax. As a result, SDG&E's surcharge rate calculations exclude a high percentage of total SDG&E gas sales (over 60 percent) to the classes of customers specified in Regulation Section 23-16, including sales for power generation, sales for resale, and other specified end uses.</p> <p>31. Our review of SDG&E's payments to and collections from the BOE, indicates that the calculations and payments by SDG&E were made correctly, while the payments to SDG&E from the BOE were delayed.</p> <p>32. In PY 2001 and 2002, SDG&E properly calculated PPP revenue collections and made appropriate payments to the BOE. Because of differences in actual volumetric sales and the sales volumes used to calculate the approved rates, SDG&E collected approximately \$378,000 more than its liability to the BOE.</p> <p>34. SCG treats the PPP gas surcharge and payments to the BOE as an excise tax. As a result, a significant portion of the therms sold are not subject to the surcharge (54 percent); however, not all exemptions are tax related.</p> <p>35. Prior to the implementation of Assembly Bill (AB) 1002 on January 1, 2001, PPP revenues were embedded in the transportation rates and not separately tracked. As required by AB 1002, after January 2001, SCG began tracking gas PPPC revenue.</p> <p>36. In 2001 and 2002, customer-billed PPP revenues exceeded the authorized revenue requirements by \$20.9 million. From 1998 through 2000, the estimated PPP revenues were \$26.3 million less than the authorized revenue requirements.</p> <p>37. PPP billed revenues differ from the amount of remitted to the BOE. The BOE remittance was \$203.3 million for the two year period, while the amount collected from customers was \$204.5 million. Payments to the BOE were made correctly. Payments to SCG from the BOE were significantly delayed.</p> <p>38. With the possible exception of the interest calculation, SCG's entries to the gas balancing accounts were made correctly.</p>	NA	
Regulatory Accounts - Gas	15. PG&E's gas balancing accounts properly reflect the PPP revenues.	NA			

Exhibit I-4: Conclusions by Utility

2. Accounting Oversight and Funds Management

	PG&E	SCE	SDG&E	SCG
Corporate Control Environment	<p>1. PG&E has an adequate internal audit program that makes a positive contribution to the design and implementation of PGC program systems and internal controls.</p> <p>20. While SCE's energy efficiency staff is knowledgeable and adequately trained, the manner in which certain tasks are allocated among staff and vendors is not sufficient to preclude or detect potential irregularities. Additionally, there is inadequate planning for staff continuity if some positions are vacated.</p>	<p>19. Despite SCE's corporate control consciousness, energy efficiency programs and expenditures are not adequately reviewed and audited. Control deficiencies exist, but were not identified by SCE personnel.</p>	<p>36. SDG&E has demonstrated sufficient commitment to regulatory compliance and internal control in the design of its Energy Efficiency Programs organization.</p> <p>37. Although elements of the energy efficiency program system of controls are designed within the framework of the broader Sempra Energy corporate policies and controls, during the audit period, the energy efficiency program did not consistently comply with these controls.</p>	<p>53. SCG administers energy efficiency programs in a lax environment with limited controls. The enforcement of controls is uncertain and decision-makers do not utilize the supporting analyses that are standard business practice in most companies.</p> <p>54. Only one audit of energy efficiency programs was performed during the audit period and the results of that audit have not been implemented in a timely manner.</p> <p>38. Sempra has an adequate internal audit program that makes a positive contribution to the design and implementation of PGC program systems and internal controls.</p> <p>39. Incentive and rebate processing during the audit period may have been compromised by weaknesses in the related systems of internal controls.</p>

Exhibit I-4: Conclusions by Utility

2. Accounting Oversight and Funds Management

Program Design and Funding	PG&E	SCE	SDG&E	SCG
	<p>2. During program years 1998 through 2000, PG&E's process to track the status of budgets and expenditures throughout the year was fragmented and ad-hoc in nature. PG&E's financial reporting capabilities improved following the Commission's establishment of quarterly reporting requirements in 2000.</p> <p>3. PG&E has established adequate controls to ensure that funds are not shifted between programs or program years without proper authorization.</p>	<p>21. During the audit period, the program selection and funds allocation process was a collaborative process involving the Commission, the CBEU, the Utilities, other interested parties, and in some cases the public. SCE participated in this process and programs were developed and funded in accordance with the Commission's objectives.</p> <p>22. SCE appropriately communicates Commission requirements to program and project staff who are held accountable for compliance with Commission requirements. SCE management tracks progress against Commission goals.</p> <p>23. SCE's fund shifting activities are in accordance with Commission guidelines and policy goals, and SCE's decision-making process for determining fund shifting opportunities is adequate.</p>	<p>40. SDG&E made an adequate effort to contribute to the design of PG&C programs and policies.</p> <p>41. SDG&E establishes program budgets based directly on the budgets approved by the Commission and had an effective process to track expenditures.</p> <p>42. SDG&E does not have any formal guidelines or processes to identify and evaluate fund-shifting opportunities, except for the guidelines that are provided by the Commission. Although SDG&E fund shifting was consistent with the Commission's directives, SDG&E's approach to fund shifting in 2002 caused unnecessary budget variances and led to SDG&E missing a fund shifting opportunity.</p> <p>43. In 2002, SDG&E did not consistently meet its energy efficiency program goals. The existing reporting infrastructure provides timely information necessary to identify problems and objectives. However, management does not consistently act upon this information in a timely manner.</p>	<p>55. The program selection and funds allocation process is consistent with Commission direction, although SCG relies on Commission for program and budget selection as well as funding.</p> <p>56. SCG's fund shifting activities are in accordance with Commission limitations as to amounts shifted per year; however, SCG's decision making process for determining fund shifting opportunities is deficient.</p>

Exhibit I-4: Conclusions by Utility

2. Accounting Oversight and Funds Management

PG&E	SCE	SDG&E	SCG
<p>Program Oversight and Management</p> <p>4. PG&E has established a formal goal setting and performance evaluation process for the energy efficiency program managers that fosters accountability.</p> <p>5. PG&E's policies and procedures over the contractor selection process provide a reasonable level of assurance that such contractors are selected in accordance with sound business practices.</p> <p>6. PG&E has adequate processes to monitor and control contractor activities and to verify work performed by contractors.</p> <p>7. blueCONSULTING found no indication that PG&E shifted funds without proper authorization. However, blueCONSULTING identified the possibility that PG&E incorrectly classified \$1.4 million in Savings by Design Program customer incentives, resulting in the effective shifting of program year 1999 funds to program year 2000.</p> <p>8. PG&E did not perform a reconciliation of outstanding commitments for program years 1998 through 2001 until January 2002.</p> <p>9. There are indications that commitments are overstated for the Savings by Design program.</p>	<p>24. Program performance is reviewed by Program Managers and senior energy efficiency management.</p> <p>25. SCE made efforts to mitigate the potential negative effects of the commitment process and blueCONSULTING's audit found no evidence of SCE abuse of the commitment process.</p> <p>26. SCE's resource planning and procurement practices are inadequate. SCE does not utilize appropriate criteria when making initial outsourcing versus in-house decisions; although consistent with stated corporate policy, SCE's contractor and vendor selection processes do not promote competitive selection.</p> <p>27. Contractor and vendor monitoring is inadequate. SCE has no direct processes to ensure the work has actually been performed by the vendor for certain programs. As a result, SCE exposes its programs to potential abuse.</p> <p>28. Controls and monitoring of on-site inspections, when performed, are adequate. However, discretionary overrides of programs selected for inspection diminishes the overall effectiveness of the controls.</p>	<p>44. During the audit period, SDG&E did not have adequate procedures relating to the selection and control of contractors.</p> <p>45. SDG&E does not always follow Sempra's competitive bidding procurement policy, although the policy itself is somewhat vague.</p> <p>46. The reporting of annual energy efficiency program costs to the Commission reflects actual expenditures and commitments, as do the financial statements for these programs. SDG&E tracks actual expenditures against commitments, but this is not reported to the Commission.</p>	<p>57. SCG does not prepare any periodic written energy efficiency budget to actual analyses, nor does it track progress against specific goals other than the annual goals set by the Commission.</p> <p>58. While SCG achieved its 2002 milestone goals (e.g., hard-to-reach (HTR), surveys completed), it failed to achieve its thermal savings goals in three of its six programs with energy savings goals.</p> <p>59. The energy savings associated with commitments dropped in future years are not routinely assessed against the energy savings amounts claimed in the year of the commitment. Thus, annual reports showing the percentage of energy savings goals achieved are subject to change in subsequent years as drop-offs occur, and reported energy savings may be higher than actual, final energy savings.</p> <p>60. SCG has no formalized policies and procedures that define and control the decision-making process regarding the use of in-house staff versus vendors, although informal criteria exist.</p> <p>61. Processes used to select contractors need strengthening to assure that value is received for energy efficiency dollars spent.</p> <p>62. SCG's authorization levels for energy efficiency program expenditures have been established and disseminated through corporate policies and procedures that appear reasonable and appropriate. While the policy is good, the degree of compliance with policy is unknown, as error rates were not tracked.</p> <p>63. SCG's program for verification of vendor work and on-site inspections is not effective.</p>

Exhibit I-4: Conclusions by Utility

2. Accounting Oversight and Funds Management

	PG&E	SCE	SDG&E	SCG
Accounting and Cost Tracking	10. PG&E's internal controls over rebate and incentive processing provide a reasonable level of assurance that such payments are made in accordance with applicable program requirements. However, such controls have not always been effective in preventing questionable expenditures.	<p>29. SCE Program Managers have been assigned considerable responsibility for the review and approval of program costs and accounting, which they discharge effectively.</p> <p>Program-level review of expenditures is timely and comprehensive. Program expenditures are extensively monitored before, during and after the invoice payment process.</p>	<p>47. SDG&E's overall management of energy efficiency program expenditures met the Commission's objectives during the audit period. However, at the program and cost category level there were variances from approved budgets.</p> <p>48. SDG&E did not adequately execute its established policy related to authorized approval limits creating a risk that expenditures were inappropriately approved.</p> <p>49. SDG&E processes and procedures regarding program rebates and incentives were adequate but could be improved.</p> <p>50. During the audit period, the systems and procedures used by SDG&E for program accounting and the tracking of expenditures and commitments were adequate.</p>	<p>64. SCG uses its reports to the Commission as its primary record of budget to actual and available funds going forward, and did not develop formal, internal reports for its own use during much of the audit period.</p> <p>65. Although the processes SCG uses to disburse incentives and rebates are adequately integrated with the corporate financial accounting system, SCG has not established appropriate checks and quality control procedures regarding payment of incentives or rebates.</p>

Exhibit I-4: Conclusions by Utility

2. Accounting Oversight and Funds Management

	PG&E	SCE	SDG&E	SCG
Compliance with Program Rules	<p>11. PG&E's systems and procedures used to prepare energy efficiency program budgets and to report on the status of program expenditures have been designed and maintained in a manner that conforms to the requirements of the Commission.</p> <p>12. blueCONSULTING's review of the Residential Contractor Program and Home Energy Surveys indicate that PG&E has effective management and oversight of these programs.</p> <p>13. blueCONSULTING's review of Savings by Design files identified possible instances of non-compliance in the enforcement of commitment terms for PY 1999 and in project eligibility for PY 2001. blueCONSULTING identified other anomalies in the PY 1999 program that may constitute fund shifting.</p> <p>14. PG&E complied with the Express Efficiency program rules.</p> <p>15. PG&E has established processes to ensure its compliance with SPC rules.</p> <p>16. The results of blueCONSULTING's review of the Standard Performance Contract (SPC) programs indicate that PG&E has complied with the program rules.</p> <p>17. blueCONSULTING's review of SPC project files identified no deficiencies.</p> <p>18. blueCONSULTING's review of PG&E's SPC data identified 52 projects which remain open in spite of the fact the program is over, and three projects for which PG&E was not reimbursed the amount which it initially overpaid.</p>	<p>31. SCE has established program-specific procedures to verify participant eligibility.</p> <p>32. SCE has departed from program rules for purposes of customer service; however, this is done on an exception basis rather than as a practice.</p> <p>33. SCE has established processes to address compliance with SPC rules.</p> <p>34. With the possible exception of documentation and application requirements, SCE's SPC program was in compliance with Commission and program rules during the audit period.</p> <p>35. Controls over potential "double dipping" exist, but are manual in nature.</p>	<p>51. For the selected non-SPC programs, limited testing disclosed no compliance exceptions.</p> <p>52. SDG&E complied with the SPC program rules; however, blueCONSULTING did identify one project in which measures appear to have been installed prior to approval of the project application.</p>	<p>66. Requirements for Express Efficiency Program are not strictly followed by SCG.</p> <p>67. Funds charged to the Savings by Design program in 2002 were spent internally at SCG with little or no obvious energy savings benefit.</p> <p>68. A lack of oversight and control contributed to expenditures for Residential Audits during the audit period that seemed excessive.</p>

Exhibit I-4: Conclusions by Utility

3. Costs	Area	PG&E	SCE	SDG&E	SCG
Direct Costs	<p>1. Contract costs represented 39 percent of the energy efficiency costs during the audit period. Although our detailed testing identified some minor exceptions, we have no significant concerns in this area</p> <p>2. Incentives represent 34 percent of the energy efficiency costs in the audit period. Although our detailed testing identified some minor exceptions, we have no significant concerns in this area.</p> <p>3. PCC labor and non-labor costs are properly distributed to orders based on employee hours charged and the PCC standard rate. Although blueCONSULTING identified some deficiencies in time card documentation, we do not believe these have a material impact on the reported labor charges.</p> <p>4. Energy efficiency labor charges reflect actual payroll costs.</p> <p>7. "Other" costs represent five percent of the total energy efficiency costs in the audit period. blueCONSULTING's review has identified some transactions in this cost category that should be re-classified, but found no costs that were not energy efficiency related.</p>	<p>14. In general, SCE's direct energy efficiency costs are properly supported and classified. Minor exceptions were noted; however, no material adjustments were identified. Identified adjustments are presented because SCE intends to correct the accounting.</p> <p>15. Controls over the use of corporate advertising contracts are insufficient to ensure energy efficiency costs are appropriately accounted for.</p> <p>16. Cost controls are inadequate to ensure purchase order (PO) limits are not exceeded in a given year. When a program is extended for a new program year, SCE issues a change order to increase an existing PO amount, instead of issuing a new PO. Significant increases are also authorized within a program year. This practice does not allow for adequate monitoring of expenditures.</p> <p>17. During the audit period, SCE's corporate guidelines for the proper use of procurement cards were violated.</p> <p>18. Controls over charges to CTAC and AgTAC should be improved in light of the dual-funded nature of these programs.</p> <p>19. SCE employed two different methods of accounting for expenses and revenues associated with joint-utility programs.</p>	<p>22. Documentation of employee labor charges to energy efficiency programs is inadequate. We are unable to conclude direct labor costs relating to energy efficiency program delivery are reasonable and properly classified in accordance with applicable accounting principles and regulatory requirements because of the large number of exceptions in the test sample.</p> <p>23. SDG&E has properly accounted for energy efficiency employee total compensation. However, distribution of labor charges to energy efficiency programs is not adequately supported.</p> <p>24. In some cases, SDG&E is not receiving adequate value for its expenditure of energy efficiency labor dollars.</p> <p>25. Charges contained in the database of "other" charges are primarily vendor payments. In general, they are adequately supported, appear reasonable and are properly classified as energy efficiency program costs in accordance with applicable accounting principles and regulatory requirements.</p> <p>26. SDG&E has entered into questionable business relationships with two former employees.</p> <p>27. The invoicing and purchase order processes lack adequate controls.</p> <p>28. Charges contained in the Rebates and Incentives database are adequately supported, appear reasonable and are properly classified as energy efficiency program costs in accordance with applicable accounting principles and regulatory requirements. However, audit tests reveal a number of departures from established corporate policy.</p>	<p>34. blueCONSULTING's ability to audit SCG's energy efficiency costs was hindered because transaction level information for 1998 was not readily available through SAP, and we were provided with little of the requested documentation for other years.</p> <p>36. SCG's expenditure accrual process is problematic, and some significant expenditures had insufficient documentation. The informality surrounding the tracking of expenses, and in particular the reclassification of expenses, diminishes the accuracy of expense accumulation and tracking.</p> <p>37. Program funding and commitments were tracked using spreadsheets and databases, allowing such costs to escape the basic controls of a double-entry accounting system. Program expenditures are tracked in the accounting system, but they are readily adjustable by a number of individuals. This lax accounting environment allows human error to go undetected and unchecked in numerous accounting processes for the program area.</p> <p>38. Several transactions tested were unsupported, had questionable costs or represented costs not related to energy efficiency programs.</p> <p>39. Labor costs for energy efficiency programs are allocated to individual cost elements based on the funding budget created by the Commission and do not reflect the actual activity underlying such costs.</p>	

Exhibit I-4: Conclusions by Utility

3. Costs		PG&E	SCE	SDG&E	SCG
Area	Indirect/Allocated Costs				
	<p>5. blueCONSULTING verified that the non-labor costs charged to provider cost centers (PCC) are costs incurred to support the general PCC activities. Our examination of 40 transactions of non-labor costs that were charged to PCCs identified only one exception.</p> <p>6. The majority of PCC-driven costs in PG&E's energy efficiency programs are from PCCs which are directly involved in the execution and support of the programs; however, there are also some charges from PCCs with no direct involvement in energy efficiency activities. We were unable to determine the exact amount of these charges, but we estimate them to be less than \$500 thousand, or .5 percent of PG&E's energy efficiency costs</p> <p>8. blueCONSULTING's analysis indicates that electric burden amounts are correct.</p> <p>9. The \$12.7 million of costs which are custom allocated are appropriately classified as energy efficiency costs and the bases for allocating the costs are reasonable.</p> <p>10. The overhead amounts associated with electric labor were calculated correctly using PG&E's "third party billing rates."</p> <p>11. Allocated (Clearing) costs include approximately \$255,000 for payroll taxes and benefits which are also included in base rates. This amount should be excluded from PG&E's energy efficiency program costs.</p> <p>12. With the exception of the possible double-counting of payroll taxes and benefit burdens included in allocated (clearing) costs and in PG&E's base rates, there is no double counting between Overhead Costs, Allocated Costs, Payroll Burdens, Custom Allocated Costs, and the Administrative & General Costs included in PG&E's base rates.</p>	<p>20. SCE charged only three types of overhead costs to the energy efficiency programs during the audit period: interdepartmental chargeback costs, costs associated with one leased facility and general administrative support costs which were treated as indirect costs beginning in 2002. Approximately \$137,000 of the IMM costs were for categories of costs which were included in base rates and should be adjusted.</p>	<p>29. Labor-related overheads included in energy efficiency program costs are properly supported by current cost allocation studies, and the basis for allocation is appropriate and reasonable.</p> <p>30. SDG&E provided an inadequate explanation and was unable to support the amount of Material Procurement and Logistics overheads included in energy efficiency program costs.</p> <p>31. The cost of employee use of assigned vehicles charged to energy efficiency program costs is reasonable. However, the Company did not adequately answer our request for information regarding the vehicle use rate.</p> <p>32. In addition to the allocated costs discussed above, energy efficiency program costs include certain other direct and indirect costs that might typically be considered overheads.</p> <p>33. Energy efficiency program costs do not include certain other types of indirect costs that might typically be considered overheads.</p>	<p>35. SCG does not have an accurate methodology for cost allocation or direct assignment of costs. The volume of costs allocated, coupled with a lack of an acceptable allocation methodology, compromised the reliability of SCG's reported results.</p>	

Exhibit I-4: Conclusions by Utility

3. Costs

Area	PG&E	SCE	SDG&E	SCG
Balancing Account	13. PG&E's energy efficiency balancing account properly reflects the energy efficiency costs recorded in PG&E's accounting system and the energy efficiency revenue requirements authorized by the Commission.	21. Differences between accounting costs and expenditures recorded in the energy efficiency balancing account, EEPAM, result from shareholder incentive costs and adjustments which could not be verified within the audit time frame.		40. SCG's method for calculating interest charges and credits to the Conservation Expense Account (CEA) differs from the method used by SGD&E, and from the method used by SCG for other balancing accounts. Through August 2003, SCG recorded \$608,509 of interest in the CEA. Under a more traditional method, SCG would have recorded (\$7,385,565), a difference of (\$7,995,074).

Exhibit I-4: Conclusions by Utility

4. Cost Classification and Reporting

PG&E	SCE	SDG&E	SCG
<p>1. Historically, the California utilities have received limited written guidance regarding the classification of administrative costs or allowed categories of costs, and past definitions have been too broad to allow meaningful comparisons of administrative cost levels.</p> <p>2. There is a wide range in the level of administrative costs reported by the utilities. Differences in programs and utility cost reporting make comparisons difficult.</p> <p>3. As a result of differences in accounting and reporting systems, differences in what is included in the utilities' base rates, and the lack of specificity regarding allowed energy efficiency expenditures, there are significant differences in the types of costs each utility charges to the energy efficiency program.</p> <p>4. Within the administrative cost category RRM2 did not specifically define the labor, non-labor, or contract cost categories. As a result, the types of costs each utility reports in each Annual Report category vary considerably.</p> <p>5. The Quarterly Reporting Workbooks provide cost information at an implied level of detail that may not be representative of the underlying data. There are differences in the types of the costs included for some line items, as well as in how some line item costs are determined.</p> <p>6. The actual costs included in PG&E's Energy Efficiency Programs Annual Report generally reflect the accounting data. While there are some differences between the annual report and accounting totals each year, these differences are largely due to timing issues.</p> <p>7. PG&E assigns costs to cost categories in the Annual Reports based on the classification of costs in its SAP and Marketing Decision Support System (MDSS)/Tracker accounting systems. The costs in PG&E's Annual Reports generally reflect the definitions put forth by the Commission, although there are some minor classification discrepancies due to the structure of PG&E's accounting information.</p> <p>8. PG&E created new cost classifications in its cost accounting and tracking system in order to provide costs in the 2002 Quarterly Workbook categories. The cost classifications in the Quarterly Workbooks generally reflect the definitions put forth by the Commission, although there are some classification discrepancies due to the structure of PG&E's accounting information.</p> <p>9. PG&E's administrative cost levels vary considerably by program, ranging from 5 to 58 percent for program year 2002.</p>	<p>10. SCE classifies vendor payments for administrative and installation activities as incentive costs for selected programs (Appliance Recycling, Savings by Design and Hard-to-Reach) in its Annual Reports to the Commission. This overstates the incentive payments reported in the Annual Reports. These costs are properly included as direct implementation costs in the 2002 Quarterly Workbooks.</p> <p>11. SCE categorizes the costs in the Annual Reports based on their accounting classification. As a result, classification may differ from that used by the other utilities.</p> <p>blueCONSULTING's analysis identified some inconsistencies and errors in SCE's Annual Reporting of program costs.</p> <p>13. SCE's costs are directly assigned to the Quarterly Reporting Workbook cost categories using accounting codes.</p> <p>14. SCE's administrative cost levels vary considerably by program, ranging from 3 to 44 percent for program year 2002. As a result, caution must be exercised in making comparison or establishing caps.</p>	<p>15. The process that SDG&E used to assign costs to cost categories in the Annual Reports is reasonable. However, it did not report any contract costs as it did not receive sufficient guidance on what these costs included. SDG&E complied with the Commission reporting requirements to the best of its ability and knowledge of the Commission requirements.</p> <p>16. The process SDG&E uses to assign costs to cost categories in the PY 2002 Quarterly Workbooks is reasonable. The cost classifications in the PY 2002 Regulatory Reporting reports generally reflect the definitions put forth by the Commission. [SDG&E administrative cost comparison not performed within audit time frame.]</p> <p>17. The costs in SCG's Annual Reports generally match the accounting data.</p> <p>18. As a result of organizational and system changes associated with the merger between SDG&E and SCG, only limited information is available regarding the processes SCG used to compile annual reports during the first three years of the audit period.</p> <p>19. SCG's regulatory reporting of energy efficiency costs evolved over time from a rudimentary, fragmented system into a more streamlined system with internal reporting standards. From a systems perspective, the reporting improved over time; however, some elements of the accounting structure remain poorly matched to the reporting requirements of the Commission.</p> <p>20. The cost classifications in the Annual Reports do not fully reflect the Commission definitions because SCG did not always distinguish between allocated, contract and non-labor costs.</p> <p>21. SCG does not report costs in all of the categories listed in the Quarterly Workbooks due to limitations in its cost information collection process. SCG reports costs based on what is available from its own cost accumulation systems. While SCG has the systems capability to report data for all relevant categories, SCG has not chosen to use its systems to provide that level of detail. SCG believes not all cost categories may be relevant.</p> <p>[SCG administrative cost comparison not performed within audit time frame.]</p>	